Supreme Court, U. S.
FILED
AUG 21 1978
MICHAEL RODAK, JR., CLERK

IN THE

Supreme Court of the United States

OCTOBER TERM, 1978

No. ~~78~~ 288

WALTER WENCKE, et al.,

Petitioners,

v.

SECURITIES & EXCHANGE COMMISSION,

Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

WALTER WENCKE
P. O. Box 1090
Del Mar, California 92014
Telephone: (714) 756-1664

Counsel for Petitioners

Dated: August 18, 1978

INTERIM PRINTING & MAILING COMPANY
1105 WEST MORENA BOULEVARD, SAN DIEGO, CALIFORNIA 92110 — 275-3050

INDEX

	Page
OPINION BELOW	2
JURISDICTION	2
QUESTIONS PRESENTED	2
STATUTORY PROVISIONS INVOLVED	3
STATEMENT OF THE CASE	3
REASONS FOR GRANTING THE WRIT	9
I. The Decision Below Conflicts With The Supreme Court And The Second Circuit As To The Proper Interpretation Of FRCP 37 (b) (2) (c)	9
II. The Decision Below Interprets FRCP 8 (d) To Have The Mandatory Meaning, That If An Answer Is Stricken: The Allegations Of A Complaint Are Deemed To Be Correct Even When They Are Known To Be Incorrect; And The Judgments Of A Prior Court Plead In That Stricken Answer Are To Be Disregarded	12
III. The Decision Below Conflicts With The Supreme Court Which Holds That A Receiver May Not Be Sued Without Permission Of The Court Appointing Him And That A District Court May Not Interfere With The "Res" Of A State Court	14

INDEX (Continued)

		Page
IV.	The Decision Below Conflicts With The Supreme Court And The Second Circuit As To Interpretation Of The Anti-Injunction Act 28 U.S.C. 2283	16
V.	The Decision Below Conflicts With The Supreme Court On Whether Privity Is Dependent On Statutory Authority, Or On Facts And Issues Contested By Representatives Of The Real Parties In Interest	18
VI.	The Decision Below Conflicts With The Second Circuit And Sixth Circuit As To The Interpretation Of The Securities Act Of 1934 (15 U.S.C. 77)	19
CONCLUSION		23
APPENDIX (List of Petitioners; Statutes Cited; Opinion of Ninth Circuit Court of Appeals		25

CITATIONS

Page

CASES

Chicago, Rock Island & Pacific Ry. Co. v. Schendel, (1926) 270 U.S. 611, 46 S.Ct. 420, 70 L.Ed. 757	18,19
Connelly v. Balkwill, 174 F.Supp. 49 (1959) Aff'd 279 F.2d 685 (6th Cir. 1960)	21
Dopp v. Franklin National Bank, 461 F.2d 873 (2nd Circuit 1971)	11
Flaks v. Koegel, 504 F.2d 702 (2nd Circuit 1974)	11
Heckman v. U.S., 224 U.S. 413 (1911)	18
Klein v. Burke Construction Company, 260 U.S. 226 (1922)	12
Porter v. Sabin, 149 U.S. 43, 13 S.Ct. 1008, 37 L.Ed. 815 (1892)	14,15
Societe Internationale v. Rogers, 357 U.S. 197, 78 S.Ct. 1087, 2 L.Ed.2d 1255 (1958)	10
Vendo Co. v. Lektro-Vend Corp., 433 U.S. 623 (1977)	12,17
Vernitron Corporation v. Benjamin, 440 F.2d 105 (1971) at 108, cert. den. 401 U.S. 987, 91 S.Ct. 1664, 29 L.Ed. 154 (1971)	17,21

CITATIONS (Continued)

	Page
RULES	
Federal Rules of Civil Procedure,	
Rule 8 (d) (f)	3,12,14,16
Rule 28(c)	6
Rule 37 (2) (c)	3,9,10,11
15 U.S.C.	
77	19,20,21
78aa	3
78 bb (a)	3
28 U.S.C.	
1254 (1)	2
2283	16
77bb Title 15	20

IN THE

Supreme Court of the United States

OCTOBER TERM, 1978

No. _____

WALTER WENCKE, et al.,

Petitioners,

v.

SECURITIES & EXCHANGE COMMISSION,

Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

Petitioners respectfully pray that a Writ of Certiorari issue to review the judgment and opinion of the United States Court of Appeals for the Ninth Circuit entered on June 29, 1978.

OPINION BELOW

The Opinion of the Court of Appeals, not yet reported appears in the Appendix. No opinion was rendered by the District Court for the Southern Division of California.

JURISDICTION

The Judgment of the Court of Appeals, Ninth Circuit, was entered on June 29, 1978. This Petition for Certiorari was filed within 90 days of that date. This Court's jurisdiction is invoked under 28 U.S.C. 1254 (1).

QUESTIONS PRESENTED

1. Are Corporate Parties denied due process by a federal receivership, instituted without an evidentiary hearing, which strips them of funds with which to defend on the merits?
2. After striking an answer, must a District Court "deem" allegations of a Complaint to be correct which are known to be incorrect; and must it ignore judgments that were set forth in that answer?
3. May a state court receiver be sued without permission of the court appointing him?
4. May a District Court enjoin a State Court in violation of the Anti Injunction Act by "deeming" that its receivership was a device to cloak fraud?
5. Is the SEC in privity with a Corporation Commissioner where the latter had already defended the rights of the real parties in interest?

6. Is "looting of assets of publicly held corporations" and its reverse side "consideration paid" a matter of exclusive federal jurisdiction under the Securities Exchange Act?

STATUTORY PROVISIONS INVOLVED

The following statutes are set forth in the Appendix:
FRCP 37 (2) (c); FRCP 8 (d) (f); 15 U.S.C. 78 aa; 15 U.S.C. 78 bb (a).

STATEMENT OF THE CASE

A District Court stripped Corporate Defendants of funds by means of a temporary federal receiver. This prevented a defense on the merits. It then struck the answers of the defendants (who refused to be sworn because of lack of funds and suicidal litigation expense) and entered a default judgment in conformity with an unverified Securities & Exchange Commission Complaint, but *contrary to known facts*. It did this under the concept that, absent an answer, the Complaint must be deemed to be admitted. It enjoined a state court. It took away the "res" over which the State Court had imposed a State Receivership. It did this knowing the State Court had already issued judgments involving the Defendants. The Ninth Circuit upheld the District Court.

This has resulted in diametrically opposite judgments of a State Court and a District Court.

On August 7, 1975, the Eighth Judicial District of the State of Nevada in and for the County of Clark, took jurisdiction over Sun Fruit, Ltd., a publicly held company, and appointed

Walter Wencke as Receiver. The California Corporation Commissioner appeared in that litigation.

The SEC appeared in the Nevada litigation on a "de facto" basis: an officer of the SEC withheld Sun Fruit Books after being enjoined to "turn them over to the Receiver;" an SEC Attorney gave Sun Fruit Records to the Corporation Commissioner but directed they be concealed from the Nevada Court; an SEC Attorney communicated "sub rosa" with the Nevada Judge; an SEC Attorney wrote a private letter to the Nevada Judge; the Corporation Commissioner made a motion to the Nevada Court to remove Wencke as Receiver based upon "an understanding" he had with the SEC; the SEC received copies of the Receiver's Reports and seven Nevada Judgments; the SEC and Corporation Commissioner were requested to correct any facts, but, neither corrected any facts.

The Seven Nevada Judgments were not appealed.

The SEC monitored the Nevada proceedings. It waited one year before it filed a Complaint against Wencke, Sun Fruit and other corporate petitioners in the District Court. The identity of all the petitioners is set forth in the appendix.

The thrust of the SEC Complaint was that hotels had been "looted" from Sun Fruit by Wencke and corporate petitioners controlled by him.

Contrariwise, the thrust of the Nevada Judgments was that the hotels had been "purchased" from Sun Fruit. The Nevada judgments also set forth the balance due on the purchase.

The Nevada Court found that Wencke was *not* guilty of negligence or breach of duty and that a Mr. Mets had falsified Records to "deceive Wencke" and to cover up frauds committed by Mets. It refused to remove Wencke as Receiver.

The SEC Complaint duplicated the already concluded Nevada litigation. The factual content was the same. The real parties in interest were the same (Sun Fruit, Ltd. and its public investors on one side and the various corporations that purchased the Hotels from Sun Fruit (*i.e.*, Hawksfoot, Zippe, etc.) on the other. The purpose of the Regulatory Agencies was identical. The Corporation Commissioner intervened in Nevada to "protect the investors in Sun Fruit, Ltd." while the SEC brought its action in the District Court "on behalf of public investors." Both agencies also had the same objective of removing Wencke as receiver.

The answers denied the material allegations of the Complaint and asserted: The Nevada Court had jurisdiction over the Sun Fruit "res" and issued judgments with Findings and Conclusions which were res judicata; the SEC was in privity with the Corporation Commissioner; the SEC had appeared directly in the Nevada Court by being an "actor;" and, the anti-injunction Act precluded a District Court from interfering with a State Court receivership and its judgments.

Pleadings and motions filed by the Petitioners pointed out: Sun Fruit was in Receivership in Nevada; Sun Fruit had no officers since they had been terminated at the inception of Receivership; no consent to sue the receiver had been given by the Nevada Court; the receiver, as receiver, had not been served; Sun Fruit was an indispensable party, and absent

that party, the District Court lacked subject matter jurisdiction. Sun Fruit itself did not appear.

On September 28, 1976, the SEC moved for an injunction and appointment of a federal Receiver and supported it with 66¾ pounds of private (non-adversary) transcripts and an affidavit.

Thereafter, the District Court notified the parties it would impose federal receiverships on the various Petitioning corporations. No witnesses were presented. There was no evidentiary hearing. Contrariwise the Nevada judgments were based on adversary proceedings in which witnesses appeared and were cross-examined.

On December 14, 1976, the petitioners discovered that an officer of the SEC had tampered with evidence and that 295 exhibits from transcripts and 593 pages from an affidavit had been deleted. The transcripts contained unidentified hearsay and guesses upon instructions of the SEC Attorney taking the testimony. Three transcripts were found to be unsworn. The deponents in the private SEC depositions had been sworn by the Attorney for the SEC in violation of FRCP Rule 28 (c). In other words, there was not one single untainted document before the District Court when the Receiverships were imposed.

The petitioners moved to strike the SEC exhibits as tampered and invalid. The SEC argued that the Court had already decided their evidentiary value and they were "the law of the case."

On December 20, 1976, the District Court, without an evidentiary hearing, signed an Order for a preliminary injunction and appointed a temporary federal receiver. *This action had the effect of depriving the Corporate Petitioners of all of their funds and precluded them from defending on the merits. It was the decisive order in the case.*

On January 26, 1977, to bring matters to a head, Walter Wencke refused to be sworn. He asserted the District Court lacked jurisdiction; there would be "suicidal litigation expense;" the corporate defendants had been stripped of funds and did not have the means to proceed; and, legal costs would amount to "hundreds of thousands of dollars for an adequate defense."

The District Court, because of that refusal, struck the answers. A default judgment was entered based upon the allegations of the SEC Complaint which (because the answer was now stricken) were "deemed to be correct."

However, the Findings of Fact and the Judgment of the District Court, although in accord with the unverified Complaint, *were in variance with the known facts.*

The District Court Judgment recites that Wencke is an agent-officer of Sun Fruit and was served as an agent-officer, when, in fact, Wencke was really the Receiver of Sun Fruit and the agent of the Nevada Court.

The District Court Judgment recites that various hotels were "valuable assets" of Sun Fruit which had been "looted" by Wencke by means of Corporations Hawksfoot, Inc. and Zippe, Ltd.

The prior Nevada Judgments, set forth in the stricken answer however, dealt with the "purchase" of those assets and established that: the hotels in the aggregate consistently lost money; it was advantageous for Sun Fruit to dispose of them; and, Hawksfoot/Zippe were owned by a Charitable Trust in which Wencke had no beneficial interest. The Nevada Court then rendered judgment among Sun Fruit and Hawksfoot/Zippe, establishing the money that was owed by Hawksfoot/Zippe to Sun Fruit.

The District Court Judgment enjoined the Nevada Court. The Corporation Commissioner and the United States then moved the Nevada Court that it alter its judgments "ab initio" and adopt the Findings of the District Court. The Nevada Court refused. The Nevada Court kept intact its prior judgments; the acceptances of claims of creditors; and, the rejections of claims of creditors. The Nevada Court then terminated its receivership on the basis of "comity."

The United States and the Corporation Commissioner did not appeal the Nevada Court's rulings.

There are now two contradictory lines of judgments:

In Nevada, the title to various hotels has been adjudicated for Hawksfoot/Zippe with a money judgment for Sun Fruit for the balance due on a purchase.

In the District Court, with "service" upon Sun Fruit being "deemed" made through Wencke as an "agent-officer of Sun Fruit," those same hotels are "deemed" to be "looted" from Sun Fruit, and the Nevada Receivership is "deemed" to be a fraud.

The practical consequence is that a multiplicity of litigation has ensued among judgment holders, accepted creditors, and rejected creditors depending upon the line of judgments most beneficial to them.

The far seeing consequence is that judgments of one court can be varied or destroyed in another court by imposing a temporary receivership, thereby denying funds to proceed, and consequently obtaining a different judgment.

REASONS FOR GRANTING THE WRIT

I.

THE DECISION BELOW CONFLICTS WITH THE SUPREME COURT AND THE SECOND CIRCUIT AS TO THE PROPER INTERPRETATION OF FRCP 37 (b) (2) (c)

The Ninth Circuit conflicts with the Supreme Court and the Second Circuit, on whether a refusal to respond, after petitioners have been stripped of funds by a federal receiver, is "willfull."

The Petitioners, in refusing to be sworn, pointed out:

> ". . . this Court does not have jurisdiction. I recognize the risk of incurring this Court's displeasure; but, I respectfully point out that the alternative is suicidal litigation expense.
>
> " 'Trial of this matter will take weeks, with dozens of witnesses and hundreds of exhibits' . . . 'hundreds of hours of expensive

> attorney's time will be involved' . . . 'legal costs can amount to hundreds of thousands of dollars for the presentation of adequate defenses.' "

That allegation was never rebutted by the SEC. There was no evidentiary hearing.

The Ninth Circuit found this to be a "willful" refusal under FRCP 37 (b) (2) (c) stating:

> "In order to attack . . . jurisdiction and to avoid litigation expenses, Wencke refused to be sworn . . .
>
> ". . . Wencke . . . argued that discovery and other litigation costs, combined with the receiver's refusal to provide corporate funds . . . , forced him to challenge jurisdiction in the manner described. . . ."

The Supreme Court in *Societe Internationale v. Rogers*, 357 U.S. 197, 209, 78 S.Ct. 1087, 1094, 2 L.Ed.2d 1255 (1958), stated:

> "The provisions of Rule 37 . . . must be read in light of the provisions of the Fifth Amendment that no person shall be deprived of property without due process of law . . . there are constitutional limitations upon the power of the courts, . . . to dismiss an action without affording a party the opportunity for a hearing on the merits. . . ."
>
> ". . . Rule 37 should not be construed to authorize dismissal of this complaint because of petitioner's noncompliance with a pretrial production order when it has been established

> that failure to comply has been due to inability, and not to willfulness, bad faith, or any fault of petitioner.

Wencke and the Corporate Petitioners, after being stripped of funds, had the Hobson's choice of proceeding without counsel, or, of refusing to be sworn. However, the Ninth Circuit stated of this:

> "he made the choice knowing the result and intending to rely upon the jurisdictional issue."

Such a "choice" cannot be "willful" in a constitutional sense. The petitioners were entitled to their own funds for attorneys' fees and other expenses incidental to preparation for trial. They were entitled to proceed with counsel.

The Ninth Circuit emphasis on "choice" conflicts with the Second Circuit in both *Flaks v. Koegel,* 504 F.2d 702 (1974) and *Dopp v. Franklin National Bank,* 461 F.2d 873 (1971). These cases hold that Rule 37 requires articulation of a standard of willfulness in the order of default and that there be an evidentiary hearing. In the matter below, the District Court obviously knew of its own order imposing the federal receiverships and knew the corporate petitioners had no funds. It did not set forth a standard of willfulness.

II.

THE DECISION BELOW INTERPRETS FRCP 8 (d) TO HAVE THE MANDATORY MEANING, THAT IF AN ANSWER IS STRICKEN: THE ALLEGATIONS OF A COMPLAINT ARE DEEMED TO BE CORRECT EVEN WHEN THEY ARE KNOWN TO BE INCORRECT; AND THE JUDGMENTS OF A PRIOR COURT PLEAD IN THAT STRICKEN ANSWER ARE TO BE DISREGARDED

The opinion of the Ninth Circuit conflicts with the decision of the Supreme Court in *Klein v. Burke Construction Company*, 260 U.S. 226 (1922) and *Vendo Co. v. Lektro-Vend Corp.*, 433 U.S. 623 (1977).

Klein v. Burke holds that where two courts are involved:

> "Whenever a judgment is rendered in one of the Courts and pleaded in the other, the effect of that judgment is to be determined by application of the principle of *res adjudicata*." (at 230)

In the case below the answer of the petitioners pleaded the Nevada judgments between Sun Fruit on the one hand and Hawksfoot/Zippe and Wencke on the other hand.

FRCP Rule 8 (d) reads:

> "Averments in a pleading are admitted . . . when not denied by a responsive pleading."

The Ninth Circuit construed Rule 8 (d) to mean that *facts known to be incorrect must be "deemed" admitted*, after an answer is stricken, if they are set forth in the Complaint.

The Ninth Circuit pointed out that Wencke refused to obey the discovery order, therefore the District Court had authority to strike the responsive pleading; and, since there now was no responsive pleading in the record, allegations of the SEC Complaint must be "deemed to be admitted." It then stated:

> "Under the facts *as we must accept them*, the Nevada Receivership of Sun Fruit was simply a continuation of Wencke's fraud." (italicizing supplied)
>
> and
>
> "the state receivership was a protective cloak for Wencke to throw over his continued looting."

The incorrect facts "deemed" to be "correct" that "must be accepted" are that:

1. Wencke was an "officer" of Sun Fruit. (But Sun Fruit was in Receivership and Wencke was not an officer but was its Court appointed receiver.)

2. The District Court had "jurisdiction" over Sun Fruit because service of process had been made upon an "officer."

3. Assets of Sun Fruit were "looted" by the Petitioners. (In fact, the Nevada Judgment discussed the "consideration" involved and rendered a money judgment for Sun Fruit.)

4. Wencke had committed a fraud. (In fact, the Nevada Court retained him as a receiver after a similar contention was made by the Corporation Commissioner; it found he had been deceived by another (Mets).)

The interpretation given to FRCP 8 (d) has far reaching implications in that a *mechanical legalism is given a higher value than a known truth or prior judgment.*

III.

THE DECISION BELOW CONFLICTS WITH THE SUPREME COURT WHICH HOLDS THAT A RECEIVER MAY NOT BE SUED WITHOUT PERMISSION OF THE COURT APPOINTING HIM AND THAT A DISTRICT COURT MAY NOT INTERFERE WITH THE "RES" OF A STATE COURT

The opinion of the Ninth Circuit is in direct conflict with the Supreme Court.

The Ninth Circuit held relative to the receivership that:

> "service upon Wencke as an officer was sufficient to bring Sun Fruit within the District Court's jurisdiction."

The Supreme Court in *Porter v. Sabin,* 149 U.S. 43, 13 S.Ct. 1008, 37 L.Ed. 815 (1892) held:

> "No suit, unless expressly authorized by statute, can be brought against the Receiver *without the permission of the Court which appointed him.*"

No statute in Nevada permits the receiver to be sued without leave of Court. No request was made by the SEC for permission to sue the Receiver. No permission of the Nevada Court to sue the Receiver of that entity was obtained. The

Receiver was not served. That Receivership Entity did not appear in the District Court.

The Supreme Court in *Porter v. Sabin* (*supra*) highlighted the impropriety of a District Court dealing with property belonging to an estate within the control of a State Court saying:

> "The reasons are yet stronger for not allowing a suit against a receiver appointed by a state court to be maintained, . . . by a court of the United States, . . . Until the administration of the estate has been completed and the receivership terminated, no court of the one government can by collateral suit assume to deal with rights of property or of action, constituting part of the estate within the exclusive jurisdiction and control of the courts of the other."

IV.

THE DECISION BELOW CONFLICTS WITH THE SUPREME COURT AND THE SECOND CIRCUIT AS TO INTERPRETATION OF THE ANTI-INJUNCTION ACT 28 U.S.C. 2283.

By the process of "deeming" the allegations of the Complaint to be "admitted" after the answer was stricken, the District Court found it had jurisdiction and enjoined the Nevada Court. The Ninth Circuit upheld this stating:

> "The district court had jurisdiction to enjoin the Nevada State Court. Title 28 U.S.C. §2283, which prohibits federal injunctions of state court action . . . does not apply to injunctions issued at the request of the United States."
>
> ". . . the appointment of a federal receiver was not barred by the state receivership. *Under the admitted facts,* the Nevada receivership was simply a device to cover Wencke's fraud. Thus a federal receiver was necessary to prevent further violations of federal securities laws and to protect the public investors." (italics added)

Clearly, the Nevada Court, which had custody of the Sun Fruit "res," did not admit that its receivership was a device to cloak fraud. In point of fact, it refused to adopt the District Court's findings. In other words, the Ninth Circuit finds that an "admission" in consequence of default under FRCP (8) (d) was made by Wencke as an "officer" of Sun Fruit and this admission can be used to enjoin the State Court and the Receivership.

The Ninth Circuit therefore is in conflict with both the Supreme Court and the Second Circuit. The Second Circuit held:

> "The policy of the Anti-Injunction Statute . . . is to prohibit enjoining of State Court suits except in those situations where the real or potential conflict threatens the very authority of the federal court." *Vernitron Corporation v. Benjamin,* 440 F.2d 105 (1971) at 108, cert. den. 401 U.S. 987, 91 S.Ct. 1664, 29 L.Ed. 154 (1971).

The Supreme Court has held:

> ". . . the Act is an absolute prohibition against any injunction of any state court proceedings, unless the injunction falls within one of the three specifically defined exceptions in the Act. The Act's purpose is to forestall the inevitable friction between the state and federal courts that ensues from the injunction . . ." *Vendo Co. v. Lektro Vend. Corp.,* 433 U.S. 623 (1977).

The Supreme Court then pointed out that "necessary in aid of jurisdiction" was confined to cases where the Federal Court already had possession of the "res."

The Ninth Circuit decision is the exact opposite. The State Court had possession of the "res" and had already issued judgments. The District Court by "deeming" allegations of an unverified complaint to be correct that Wencke was an "officer" (when he was really a "Receiver") and that "looting" occurred, found it had jurisdiction and enjoined the State Court and its judgments and took over the res. Obviously, the State Court admitted nothing.

V.

THE DECISION BELOW CONFLICTS WITH THE SUPREME COURT ON WHETHER PRIVITY IS DEPENDENT ON STATUTORY AUTHORITY, OR ON FACTS AND ISSUES CONTESTED BY REPRESENTATIVES OF THE REAL PARTIES IN INTEREST.

The Ninth Circuit held tht the SEC is not in privity with a Corporation Commissioner and may enforce a Federal Act on behalf of public investors notwithstanding prior decisions of the State Court involving those public investors and their representatives. It stated:

> "while both may assert the public interest, each enforces different statutes created by different sovereigns."

That opinion conflicts with the Supreme Court in *Chicago, Rock Island & Pacific Ry. Co. v. Schendel,* 37 (1926) 270 U.S. 611, 46 S.Ct. 420, 70 L.Ed. 757 which holds that a prior judgment is binding in other litigation when the interest of the same beneficiary is represented in both suits, even though the representative or the form of representation in the two suits be different.

In *Heckman v. U.S.,* 224 U.S. 413 (1911), the United States brought action on behalf of Indians. It was held that thereafter the Indians themselves could not relitigate the same matter.

The point is this: Sun Fruit itself was before the Nevada Court, and, in addition, the real parties in interest, the public

investors in Sun Fruit, were represented by the California Corporation Commissioner. The real parties in interest cannot have the same matters ("purchase" as opposed to "looting") relitigated for them in the District Court through a different securities' body (SEC) simply because it enforces a different law. Whether or not a person was a party to a prior suit,

> "must be determined as a matter of substance and not of mere form. The essential consideration is that it is the right of the (same person) which was presented and adjudicated in both courts." *Chicago RI and P Ry Co. v. Schendel (supra).*

VI.

THE DECISION BELOW CONFLICTS WITH THE SECOND CIRCUIT AND SIXTH CIRCUIT AS TO THE INTERPRETATION OF THE SECURITIES ACT OF 1934 (15 U.S.C. 77).

The Ninth Circuit held the issue of "looting of assets" falls exclusively within the Securities Act of 1934 stating:

> "The Securities & Exchange Commission sued Walter Wencke . . . and a number of corporations which he . . . controlled alleging that he was 'looting the assets of publicly held companies' in violation of the Securities Act of 1933 and Securities Exchange Act of 1934."
>
> ". . . Most of the SEC's claims are under the Securities Exchange Act of 1934 when Federal Jurisdiction is exclusive."

The opinion that "looting of assets" is under the exclusive jurisdiction of the '34 Act conflicts with the Sixth Circuit and the Second Circuit.

The Nevada Court determined the facts as to the "consideration" paid. Consideration is the reverse side of the coin of "looting" or lack of consideration.

Under the Securities Exchange Act of 1934 the District Court has "exclusive" jurisdiction to enforce actions over filings, information reports, etc.

There are, however, two obvious exceptions:

First: If facts have already been found by another Court then the SEC cannot ask a District Court to make a "different" finding on the pretext that the '34 Act gives the District Court jurisdiction over enforcement of the "filing" of facts. Clearly, in the instance where facts have already been found by another Court, the "filing" of those facts becomes a ministerial act and the District Court cannot make a different finding.

Second: The word "exclusive" is drained of full substance by the proviso in 77bb Title 15 that the rights and remedies "are in addition to any and all other rights that may exist in law and equity."

As part of those "other rights" the California Corporation Commissioner also has the right in law and equity to require that any filings be truthful and complete. He appeared in Nevada. Further, the SEC had contact with the Nevada Court.

Connelly v. Balkwill, 174 F.Supp. 49 (1959) Aff'd 279 F.2d 685 (6th Cir. 1960) stated:

> "Section 78aa, Title 15, vests exclusive jurisdiction in the District Courts . . . This does not mean that the state courts were without jurisdiction to hear and determine the issues in the previous action which arose out of the same transaction. (It) provides in part:
>
> > 'The rights and remedies provided by this chapter shall be in addition to any and all other rights and remedies that may exist at law or equity. . . .' "

The Court then stated, at page 60:

> "It is beyond the competence of this Court to review the judgment of the state court in the previous action . . . even if the final judgment in that action was erroneous it would nevertheless constitute a bar to the maintenance of this action. . . ."

In *Vernitron Corporation v. Benjamin,* 440 F.2d 105 (1971) cert. den. 402 U.S. 987, 91 S.Ct. 1664, 29 L.Ed. 154 (1971), a corporation sued the principal of another corporation, the assets of which had been sold to plaintiff corporation's affiliate, in exchange for common stock, for alleged violations of Securities Exchange Act and for common law fraud and breach of contract. A District Court issued an order staying prosecution of an action in the Supreme Court of New York, as "necessary in aid" of the federal court's exclusive jurisdiction over matters arising under the Securities Exchange Act of 1934.

The Second Circuit, however, disagreed, stating:

> "There can be no question but that the doctrine of collateral estoppel would be applied in any instance where the state court had determined a factual issue arising in a subsequent federal litigation."
>
> "*There is no reason why the state court cannot or should not determine issues of fact and state law relevant thereto as they come up in the state litigation.* The subsequent effect of collateral estoppel, far from requiring the federal court to stay proceedings in the state court, is *a result which should be welcomed to avoid the task of reconsidering issues which have already been settled by another competent tribunal. Klein v. Walston Co.*, 432 F.2d (2nd Cir. 1970);" (italics supplied)

The practical consequence of the Ninth Circuit's decision is to cast doubt on whether a State Court can determine common law and State Statutory matters involving "consideration" and "looting" when a public company is involved. It will lead to a substantial expansion of federal jurisdiction.

CONCLUSION

For these reasons, a writ of certiorari should issue to review the Opinion of the Nith Circuit.

Respectfully submitted,

WALTER WENCKE

Counsel for Petitioners

APPENDIX

The Petitioners in this case are: Walter Wencke, Hawksfoot, Ltd., Zippe, Ltd., Cathryn Wencke, Santa Fe Financial, Inc., Irreantum, Inc., The Grape Institute, Inc., Teh Butt Trust, The Sailor Trust, The Grape Institute Trust, TIME-Lenders, Inc., The San Diego Environmental Charitable Trust, Rinn Corp., 17th Corp., Sundowner Corp., Royal Executive Inn-Sunnyvale, Inc., Rinn Motor Hotels, Inc., Rinns of Utah, Inc., Business Consultants, Inc., The Barbara Corporation and Familia 4, Ltd.

FRCP 8

(d) Effect of Failure To Deny. Averments in a pleading to which a responsive pleading is required, other than those as to the amount of damage, are admitted when not denied in the responsive pleading. Averments in a pleading to which no responsive pleading is required or permitted shall be taken as denied or avoided.

(f) Construction of Pleadings. All pleadings shall be so construed as to do substantial justice.

FRCP 37

(b) Failure to Comply with Order.

(1) *Sanctions by Court in District Where Deposition is Taken.* If a deponent fails to be sworn or to answer a question after being directed to do so by the court in the district in which the deposition is being taken, the failure may be considered a contempt of that court.

(2) *Sanctions by Court in Which Action is Pending.* If a party or an officer, director, or managing agent of a party or a person designated under Rule 30(b)(6) or 31(a) to testify on behalf of a party fails to obey an order to provide or permit discovery, including an order made under subdivision (a) of this rule or Rule 35, the court in which the action is pending may make such orders in regard to the failure as are just, and among others the following:

(C) An order striking out pleadings or parts thereof, or staying further proceedings until the order is obeyed, or dismissing the action or proceeding or any part thereof, or rendering a judgment by default against the disobedient party;

15 U.S.C. 78aa

§ 78aa. Jurisdiction of offenses and suits

The district courts of the United States, [the Supreme Court of the District of Columbia] the United States District Court for the District of Columbia, and the United States courts of any Territory or other place subject to the jurisdiction of the United States shall have exclusive jurisdiction of violations of this title [15 USCS §§ 78a et seq.] or the rules and regulations thereunder, and of all suits in equity and actions at law brought to enforce any liability or duty created by this title [15 USCS §§ 78a et seq.] or the rules and regulations thereunder. Any criminal proceeding may be brought in the district wherein any act or transaction constituting the violation occurred. Any suit or action to enforce any liability or duty created by this title [15 USCS §§ 78a et seq.] or rules and regulations thereunder, or to enjoin any violation of such title [15 USCS §§ 78a et seq.] or rules and regulations, may be brought in any such district or in the district wherein the defendant is found or is an inhabitant or transacts business, and process in such cases may be served in any other district of which the defendant is an inhabitant or wherever the defendant may be found. Judgments and decrees so rendered shall be subject to review as provided in sections 128 and 240 of the Judicial Code, as amended (U.S.C., title 28, secs. 225 and 347). No costs shall be assessed for or against the Commission in any proceeding under this title [15 USCS §§ 78a et seq.] brought by or against it in the Supreme Court or such other courts.

(June 6, 1934, c. 404, Title I, § 27, 48 Stat. 902.)

15 U.S.C. 78bb

§ 78bb. Effect on existing law; prohibition of taxation

(a) The rights and remedies provided by this title [15 USCS §§ 78a et seq.] shall be in addition to any and all other rights and remedies that may exist at law or in equity; but no person permitted to maintain a suit for damages under the provisions of this title [15 USCS §§ 78a et seq.] shall recover, through satisfaction of judgment in one or more actions, a total amount in excess of his actual damages on account of the act complained of.

Nothing in this title [15 USCS §§ 78a et seq.] shall affect the jurisdiction of the securities commission (or any agency or officer performing like functions) of any state over any security or any person insofar as it does not conflict with the provisions of this title [15 USCS §§ 78a et seq.] or the rules and regulations thereunder.

UNITED STATES COURT OF APPEALS

FOR THE NINTH CIRCUIT

SECURITIES & EXCHANGE COMMISSION,

Appellee,

v.

WALTER WENCKE, THE BUTT TRUST, THE SAILOR TRUST, THE GRAPE INSTITUTE TRUST, THE GRAPE INSTITUTE, INC., IRREATUM, INC., et al.,

Appellants.

No. 77-1645

SECURITIES AND EXCHANGE COMMISSION,

Appellee,

v.

WALTER WENCKE, et al.,

Defendants,

and

TIME-LENDERS, INC.,

Appellant.

No. 77-1646

SECURITIES AND EXCHANGE COMMISSION,

Appellee,

v.

WALTER WENCKE, et al.,

Defendants,

and

CATHRYN WENCKE & TIME-LENDERS, INC., et al.,

Appellants.

No. 77-1647

SECURITIES AND EXCHANGE COMMISSION,

Appellee,

v.

WALTER WENCKE, et al.,

Defendants,

and

SAN DIEGO ENVIRONMENTAL CHARITABLE TRUST, HAWKSFOOT, LTD., ZIPPE LTD., RINN CORP., et al.,

Appellants.

No. 77-1648

SECURITIES & EXCHANGE COMMISSION,

Appellee,

v.

WALTER WENCKE, CATHRYN WENCKE, SANTA FE FINANCIAL, TIME-LENDERS, et al.,

Appellants.

No. 77-2146

OPINION

Appeal from the United States District Court
for the Southern District of California

Before: TUTTLE*, GOODWIN, and SNEED, Circuit Judges.

GOODWIN, Circuit Judge:

The Securities and Exchange Commission sued Walter Wencke, his wife, certain associates, and a numbe rof corporations and charitable trusts which he and his associates controlled, alleging that he was looting the assets of publicly owned companies in violation of the Securities Act of 1933 and the Securities Exchange Act of 1934.

A year before the SEC complaint, Wencke petitioned a Nevada court for a receivership of Sun Fruit, Ltd., one of his publicly owned companies. The state court obliged. Because Nevada does not require a disinterested receiver, Wencke became the receiver.

Sun Fruit, formerly Royal Executive Inns, had been the owner of certain hotels which constituted the major disputed assets. The California Corporation Commissioner appeared in the Nevada litigtion, and the SEC also had some limited contact with the Nevada court. The Nevada court found that one of Wencke's associates, and not Wencke himself, was responsible for Sun Fruit's difficulties.

When the SEC filed the pending action, Wencke and the other defendants argued that Sun Fruit was an indispensable party to the proceeding and that it could not be served without permission frm the Nevada court.

---

*The Honorable Elbert Parr Tuttle, Senior United States Circuit Judge for the Fifth Circuit, United States Court of Appeals, sitting by designation.

The district court, at the request of the SEC, issued a temporary restraining order and then a preliminary injunction, but these orders applied only to the defendants other than Sun Fruit. The district court appointed a temporary receiver for most of the corporate defendants but declined to do so for Sun Fruit and its subsidiaries because of the Nevada receivership.

Wencke's associates eventually settled with the SEC and consented to injunctions. The Wenckes and the corporations and trusts remain as defendants.

In order to attck the district court's jurisdiction and to avoid litigation expenses, Wencke refused to be sworn at a deposition the SEC had scheduled. He remained obdurate during a magistrate's hearing, pointing out to the court that this action wuld justify the imposition of sanctions against him. On the magistrate's recommendation, the district court struck the answers of all defendants and entered default judgments against them.

While Wencke now argues that discovery and other litigation costs, combined with the receiver's refusal to provide corporate funds for the purpose, forced him to challenge jurisdiction in the manner described, he made the choice knowing the result and intending to rely on the jurisdictional issue. Accordingly, we consider only issues that may be raised on appeal from a default judgment.

After entering the default, the district court issued a permanent injunction which, among other things, enjoined further proceedings in the Nevada receivership and brought Sun Fruit within the federal receivership. The court took these actions because the federal receiver had found that complete control over Wencke's entities was necessary for the receivership to achieve its purposes.

Because Wencke had willfully refused to obey the district court's discovery order, the court had the authority to strike his answer. Because Wencke was an officer, director, or managing agent of the other defendants,[1] the court also had the authority to strike their answers. Fed. R. Civ. P. 37(b)(2)(C). For the same reasons, the court had authority to enter default judgments against them. Fed. R. Civ.

P. 55; 4A J. Moore, Federal Practice, ¶ ¶ 37.03 [s.-5], 37.08. The defaults were not an abuse of discretion in these circumstances. Since the defendants had no answers in the record, they were deemed, as the court pointed out, to admit every well-pleaded allegation in the SEC's complaint. Fed. R. Civ. P. 8(d). We must, therefore, accept the facts as the SEC set them out.

The major issue on this record is whether the district court had jurisdiction over Sun Fruit and, if not, whether Sun Fruit was an indispensable party to this proceeding. Unless the Nevada receivership altered the situation, service on Wencke as an officer was sufficient to bring Sun Fruit within the district court's jurisdiction. Under the facts as we must accept them, the Nevada receivership of Sun Fruit was simply a continuation of Wencke's fraud.

Rather than a genuine attempt to preserve the property for the corporation's shareholders and creditors, the state receivership was a protective cloak for Wencke to throw over his continued looting. Wencke thus has unclean hands and may not resort to the Nevada receivership in a court of equity to insulate his fraud. Wencke was personally served when he was both an officer and the Nevada receiver of Sun Fruit. Under the admitted facts he must accept that service as sufficient. He and the other defendants are therefore precluded from denying the district court's jurisdiction over Sun Fruit.

Sun Fruit itself is not a party to this appeal. It did not appear in the district court and is free to launch a collateral attack upon the judgment against it, if it deems that course prudent. Sun Fruit's future course would not affect the parties who are before us. The Nevada receivership ended after the district court entered its final judgment, and the district court's receiver now has control of Sun Fruit. The new receiver is unlikely to attack the district court's jurisdiction, and Wencke is barred by unclean hands from asserting that Sun Fruit was not before the court. With the termination of the Nevada receivership there is no longer any obstacle to the district court's jurisdiction. Even assuming that Sun Fruit is an indispensable party, it was, for the purposes of this appeal, properly before the court below.

Most of Wencke's other issues are frivolous. The appellants seem to argue that the appearance by the California Corporation Commissioner in the Nevada proceeding somehow bound the SEC. This argument is nonsense.

The SEC is not in privity with the California Corporation Commissioner, and, while both may assert the public interest, each enforces different statutes enacted by different sovereigns. While the Nevada court and the federal courts might have concurrent jurisdiction of claims under the Securities Act of 1933, no one made such a claim in the Nevada proceeding.

Most of the SEC's claims in the current case are under the Securities Exchange Act of 1934, where federal jurisdiction is exclusive. The SEC did ot appear in the Nevada case; at most, it notified the Nevada court of the district court's action and asked it to comply with the district court's injunction against further state proceedings. There are thus no grounds for asserting collateral estoppel against the SEC.

The district court had jurisdiction to enjoin the Nevada state court. Title 28 U.S.C. § 2283, which prohibits federal injunctions of state court action in most circumstances, does not apply to injunctions issued at the request of the United States. *Leiter Minerals, Inc. v. United States,* 352 U.S. 220 (1957). This exception to the statute applies also when an administrative agency is enforcing applicable federal law. *NLRB v. Nash-Finch Co.,* 404 U.S. 138 (1971). "The purpose of § 2283 was to avoid unseemly conflict between the state and the federal courts where the litigants were private persons, not to hamstring the Federal Government and its agencies in the use of federal courts to protect federal rights." 404 U.S. at 146. Wencke's citation of *Vendo Co. v. Lektro-Vend Corp.,* 433 U.S. 623 (1977) is inapposite; there was no federal involvement in that case.

Similarly, the appointment of a federal receiver was not barred by the state receivership. Under the admitted facts, the Nevada receivership was simply a device to cover Wencke's fraud. Thus a federal receiver was necessary to prevent further violations of federal securities laws and to protect the public investors. The Seventh

Circuit upheld the appointment of a federal receiver in a somewhat similar situation. *Tcherepnin v. Kirby,* 416 F.2d 594 (7th Cir. 1969). The district court here acted within its discretion.

The appellants object to the district court's preliminary injunction and to its actions concerning bankruptcy court proceedings for two of the defendant corporations. When the court learned that Familia 4, Inc., was in bankruptcy, the court transferred its assets from the federal receiver to the bankruptcy trustee, with a provision allowing the receiver to continue his investigation of its affairs.

When the court learned that Time-Lenders, Inc., contemplated bankruptcy, it issued a temporary restraining order to preserve its assets for the federal receiver. We think that the court acted properly in relating this case to the bankruptcy proceedings. Because of the significance of Time-Lenders in the entire constellation of Wencke entities, it was important to preserve it intact for the receivership. The attacks on the preliminary injunction and the temporary restraining order do not properly before us in an appeal from a default judgment.

The appellants raise many other issues. One is that the permanent injunction grants relief beyond that requested in the complaint, in violation of Fed. R. Civ. P. 54(c). The court included Santa Fe Financial in the receivership and Meta-Financial and Investment Items in its injunction although the SEC's complaint did not request these particular inclusions. The court acted in part because the receiver though these steps to be necessary, but in doing so the court inadvertently overstepped its jurisdiction in a default judgment. We must remand for an appropriate modification.

In remanding, we note that Meta-Financial and Investment Items are wholly owned subsidiaries of Time-Lenders and that the court and the receiver could probably control their action through their control of Time-Lenders. Moreover, the SEC can file a supplemental complaint covering these companies and is free to seek temporary relief pending an adjudication on the merits. Aside from these minor problems, we find no error in the district court's actions before us on this appeal.

Affirmed in part, and remanded for modification of the decree to conform to the complaint.

SEC v. WENCKE, et al.
Nos. 77-1645, 77-1646,
77-1647, 77-1648 and 77-2146

FOOTNOTE:

[1]Defendant Cathryn Wencke is the exception to this statement. From her secondary role throughout this litigation, it is clear that Walter Wencke acted for her in refusing to be sworn and that the court therefore properly struck her answer.